

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of ~~the Appeal of~~
SUN LIGHTING FIXTURE COMPANY)

Appearances:

For Appellant: Boyle & Wood, Howard D. Emerson.

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; James J. Arditto, Franchise Tax Counsel; Hebard P. Smith, Assistant Tax Counsel.

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of the Sun Lighting Fixture Company to a proposed assessment of an additional tax in the amount of \$260.90 for the taxable year ended December 31, 1938.

The only question presented by the appeal is whether the Appellant realized taxable income on the cancellation of indebtedness to its officers, who are also its sole stockholders, for unpaid salaries accrued as expenses in prior years. The amounts of the salaries were charged to the expense account "Officers Salaries" during the years 1930, 1931 and 1932 and were credited to the individual accounts of the officers, those amounts not, however, being drawn by the officers,

On January 11, 1937, indebtedness to the officers in the total amount of \$6522.50 was cancelled and a credit made in that amount to Appellant's surplus account. The Commissioner regarded the amounts cancelled as income to Appellant for 1937 under the provisions of Section 8(o) of the Bank and Corporation Franchise Tax Act and levied his proposed assessment accordingly. The Appellant contends, however, that such amounts constitute not income but a contribution by the officers to the surplus of the corporation and that no income resulted to it since it was insolvent both before and after the contribution.

Section 8(o) of the Act, as amended by Chapter 836, Statutes of 1937, effective August 27, 1937, provided as follows:

Appeal of Sun Lighting Fixture Company

"If a bank or corporation is allowed a deduction under this section for an obligation and is subsequently discharged from liability therefor without having made full payment thereof, the amount of such obligation shall constitute income to the bank and corporation in the year in which the liability is discharged, If an obligation is not paid within four years of the date on which incurred, it shall be presumed that the bank or corporation has been discharged from liability therefor unless it can be established that (1) the obligation was incurred in good faith, (2) the bank or corporation still intends to satisfy the obligation in full, and (3) the obligation has not been paid either because the bank or corporation was financially unable to make payment or because it was unable to locate the creditor, or because the obligation is not due."

The situation involved herein has been passed upon by the Attorney General, his Opinion NS4649 of December 18, 1942, after quoting Section 8(o), stating as follows:

"Since the section specifically requires that 'the amount of such obligation shall constitute income to the bank or corporation in the year in which the liability is discharged', there seems no escape from the conclusion that the Commissioner's action in treating the cancelled obligation for salaries as taxable income in the year 1937 was correct.

"The fact that paragraph (o) was repealed in 1939 and re-enacted in part as paragraph (d) of Section 6 of the Act does not affect the situation. The Commissioner was governed in 1938 by the provisions of the Act as it then read including Section 8(o)."

We are likewise of the view that there is no escape from the conclusion that the Commissioner's action was correct. The Appellant, in support of its position, directs attention to that portion of the second sentence of Section 8(o) providing "... unless it can be established that ... (3) the obligation has not been paid either because the bank or corporation was financially unable to make payment..." It should be observed, however, that the sentence states that "... it shall be presumed..." that a corporation has been discharged from liability of an obligation is not paid within four years of the date on which incurred unless certain facts can be established. It does not purport to be a limitation upon or qualification of the preceding sentence, but constitutes rather an addition to the scope of that sentence by establishing a presumption that there has been a discharge from liability in certain cases. By its very terms, accordingly,

Appeal of Sun Lighting Fixture Company

it has no application to the situation wherein a corporation by appropriate action of its creditors is discharged from liability to them.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. **McColgan**, Franchise Tax Commissioner, in overruling the protest of Sun Lighting Fixture Company to a proposed assessment of additional tax **in the** amount of **\$260.90** for the taxable year ended December 31, 1938, based upon the income of said corporation for the year ended December 31, 1937, be and the same is hereby sustained.

Done at Sacramento, California, this 20th day of January, 1943, by the State Board of Equalization.

R. E. Collins, Chairman
Geo. R. Reilly, Member
Wm. G. Bonelli, Member

ATTEST: Dixwell L. Pierce, Secretary